

## Social Security Private Accounts: A Closer Look

President Bush has proposed to add a system of private accounts to Social Security, which would be funded by diversion of payroll tax revenue from the Social Security Trust Fund. The President has asserted that such accounts would offer workers higher returns, ownership of their retirement assets, and the ability to offer an inheritance to heirs. Based on the President's comments, materials released by the White House, and the work of his 2001 Social Security commission, we can take a closer look at those and other issues.

### Can You Have Reward Without Risk?

No. Markets set rates of return based in large part on an investment's safety. A riskier investment yields greater returns, but the chance of losing your investment is also greater. A safer investment offers less profit but a better chance of collecting it.



Social Security Trust Fund assets have always been invested in US government Treasury securities similar in concept to the Treasury Bonds held by millions of private investors. Like Treasury Bonds, these securities offer rates of return that, though modest, cover inflation and prevent the erosion of Trust Fund assets. More importantly, these securities are backed by the full faith and credit of the US government, making them the safest investment in the United States. Private accounts would open workers' retirement assets to market risks.

Enron Corporation provides a disturbing example of such risks. Enron shares sold for \$83 at the beginning of 2001, and they sold for just 26¢ at the end of that year. Enron was a corporate giant before the fall, ranking seventh on the *Fortune 500* list in 2000, so its collapse had a huge effect on the market. Enron investors lost \$60 billion, but market-wide losses following Enron's fall topped \$8 trillion.

### Would You Really Own Your Private Account?

Compare the sort of private account proposed by President Bush with an asset like your home. You can "cash out" your home whenever you wish, by selling it on the real estate market. And you can also borrow against it by taking out a home equity loan or a mortgage.



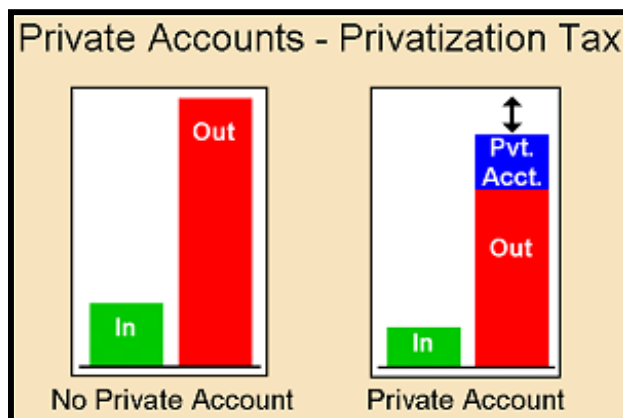
By contrast, the private accounts described by the President are a one-way door for your retirement assets. Once you decide to open a private account, you cannot cash it out before you retire, and you cannot even borrow against the value of your contributions. As compared to something you really do own – like a home – your ownership of your private account would be limited at best.

## Can Your Private Account Never Be Taken Away?

In his State of the Union Address, the President said “best of all, the money in the account is yours, and the government can never take it away.” He has since repeated that message in describing his plan for private accounts.

But because a worker who chooses to open a private account would put less into Social Security, she would also get less out. The difference – what some have called a “privatization tax” – she would have to make up with her private account. If she chooses safer, less profitable investments, her private account may fall short of the amount her Social Security benefits have been reduced. Here is how *Business Week* economics editor Peter Coy described this sort of offset:

*So the government can't take money out of your left pocket -- that's the private account. But it can accomplish the same thing by taking money from your right pocket, the traditional benefit. And you'll be just as helpless as if you never had a private account in the first place.*



## Can You Leave Your Private Account to Your Heirs?

Maybe.

Social Security offers a guaranteed stream of monthly income for the rest of a retired worker's life. To accomplish a similar goal, the private accounts system described by President Bush would use an annuity requirement.

The government would set what is in essence a minimum balance for private accounts. If a worker's private account balance were higher than that minimum balance, he would be required to convert only part of his account into an annuity contract. A company (likely an insurance company) would get that portion of his private account, in exchange for an agreement to pay monthly benefits in a pre-defined amount for the rest of his life. In that case, his private account would effectively be split – the insurance company would get the amount subject to the annuity requirement, and the remainder he might leave to his heirs.

But if a worker's private account falls short of the government-established minimum balance, she must convert the entire balance of her account to an annuity. In that case, her heirs get nothing.

